

TESTIMONY
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SURFACE TRANSPORTATION SUBCOMMITTEE
OF THE
SENATE COMMITTEE ON COMMERCE, SCIENCE, AND TRANSPORTATION

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Mr. Chairman. Government at every level has been regularly accused of reacting to major issues rather than anticipating them. No one can raise that accusation this morning.

Although it may not be making national news today, the movement toward creation of short line and smaller regional railroads is the issue of the next half-decade for the railroad industry. It's a vital issue to major carriers, who must streamline their systems if they are to compete effectively in a deregulated environment. It is an even more vital issue for thousands of shippers and communities situated on light density lines. This is the time for Congress and the Federal Railroad Administration to craft policies that anticipate the trend, and promote successful transfer of these threatened lines to smaller, independent carriers. Strengthening the economics of short line carriers has been a major objective at the Department of Transportation, and I commend this Committee for leading the way in Congress.

We've learned over the past decade that light density lines which cannot be operated profitably within the economics of a major carrier can often provide cost-effective service in the context of a short line operation or a small regional system. There are several reasons why:

1. Lower Costs:

A well-run short line railroad should have lower overhead than a Class I carrier. It can maintain a less costly equipment inventory, with power and rolling stock adapted to its own well-defined needs. Its traffic patterns allow it to maintain its roadbed to different systemwide maintenance standards. Most important, the small railroad -- whether union or non-union -- is generally free of the workrules and rigid craft lines that characterize most major carrier labor-management agreements. That enables the short line carrier to use the talents of a single employee on multiple tasks -- rather than employing several individuals on a full-time basis when their services are needed only a portion of the time.

2. Locally Oriented Marketing:

The marketing philosophies of major carriers are geared, as they must be, to heavy density line haul traffic. In contrast, the capacity of a small, locally-owned railroad to micro-market along light density lines on a car-by-car, shipper-by-shipper basis is unsurpassed. That's even more true when local shippers own all or part of the line, and have a direct financial stake in broadening its traffic base.

3. Local Service Philosophy:

The attention and resources of the major carriers inevitably focus on the things they do best, their areas of greatest profitability. Generally, they are the heaviest density, long haul operations. The small railroad lives or dies on its ability to serve the particular needs of the lighter density shipper. Their entire management philosophy is geared to that service, and they can compete with service in areas where a larger carrier would find it more difficult to do so.

There are tangible examples of these factors at work throughout the United States. In fact, there has literally been an explosion in the number of small, independent carriers created over the past five years.

In the 1950's, sixteen small carriers began operation. Twelve more were organized during the 1960's, and -- in the aftermath of the Northeast regional rail collapse -- forty-seven commenced service in the 1970's.

In contrast, over the six years' since the Staggers Rail Act of 1980 became law, 133 independent carriers have begun operation. Obviously, these numbers reflect a more active effort by major carriers to rationalize their systems by shedding lines which have suffered from demographic shifts. But they also demonstrate increased success in maintaining service over lines which ten years ago would have been abandoned, pulled from the ground and sold for salvage. There are now

approximately 393 independent carriers nationwide, not counting the roughly 80 small railroads owned by the major carriers.

In assessing the future, bear in mind that a number of major carriers are about to commence significant rationalization programs. At the same time, several regional carriers like the Illinois Central Gulf Railroad Company are midway in the process of spinning-off large segments of their systems into smaller feeder railroads so they can concentrate their resources on higher density corridors. Barring major revisions to the Staggers Act, the trend toward formation of small and regional carriers seems certain to continue, and in fact accelerate, throughout the remainder of this century.*

That is not to say -- and it's important to emphasize this -- that short line transfer is the right solution for every light density line. For all the success stories, it is essential for shippers and investors to be realistic in assessing the potential of these lines on a case-by-case basis.

- To survive over the long-term, the line must have an adequate traffic base, and shippers must assess that base realistically. Shipper investment in the line or the carrier is material, since it gives the shipper a financial incentive to keep its

* Many of the branch lines shed in the 1960's and 1970's were truly deteriorated lines -- with little or no traffic, and enormous rehabilitation needs. The abandonment of these "loss leaders" has now been largely completed, and the railroads are focusing today's rationalization efforts on lines that are better maintained and better endowed with traffic, though still too light in density to be a contributing part of a major carrier's system. The chance for preserving service on these lines with an independent railroad is much greater, and since the Gulf & Mississippi Railroad decision (Finance Docket No. 30439 Gulf & Mississippi Railroad Corporation-Purchase [Portion]-Exemption-Illinois Central Gulf Railroad Company Decided: December 13, 1984), the willingness of the major carriers to cooperate in this effort has never been stronger.

traffic on the line (rather than simply using its existence as price leverage on trucks), and an incentive to convince other local shippers to do the same. If the line serves only one major shipper, shipper investment is essential.

- It is also essential to objectively assess the condition of the line, and conservatively estimate its capital investment needs over both the short and long run. Short-term investment -- the amount needed to run the line today -- may bear little relation to long-term investment needs, particularly where bridge work or steel replacement are involved. Can the line generate enough return to amortize these costs? Is there a reasonable possibility that the line can qualify for public rehabilitation funding in one of the 22 states that offer it?
- The operator must have adequate capital to handle both foreseen costs and the unforeseen, such as floods and derailments.
- The operator must also have an adequate Class I connection (two if possible), with rate divisions sufficient to insure profitability.
- Finally, shippers must decide whether rail service is a necessity or a luxury, whether they may not have sufficient competitive options from trucks and waterways even in the absence of rail.

In the decade of the 70's, 159 small railroads went bankrupt or were abandoned -- a sober reminder of the consequences of poor or over optimistic judgments.

Looking to the future, I think we need to face the reality that most of the light density lines now being studied for abandonment will ultimately be abandoned if they are not transferred to independent operators. We believe it is in the public interest to preserve rail service wherever it is economically feasible to do so. And if we are to maximize that window of economic feasibility, there are several important issues that must be faced in the years ahead. I'm hopeful that this morning's forum will begin to focus attention and debate on those issues.

1. It is essential to preserve the labor protection guidelines established by the ICC in the Gulf & Mississippi case.

In Gulf & Mississippi, the ICC provided a powerful incentive for carriers to preserve and transfer rather than simply abandon light density lines by ruling that New York Dock and Oregon Short Line labor protection is not mandated when carriers sell a line to a new, independent railroad. As the Committee knows, the protective provisions in New York Dock and Oregon Short Line would require the seller and/or buyer to provide up to six years' full salary to every employee affected by the transfer. Imposition of these labor protection obligations materially alters the economics of many light density lines, and the risks they add to the transaction are a disincentive to private investment. Equally important,

the ability to sell a line free of residual protection obligations is a strong incentive for the major carriers to support short line operators -- both logistically and financially -- rather than opting to abandon the line. Reversing that incentive is not in the public interest.

Anyone who worked, as I did, in this area in the 1970's carries memories of the hostility demonstrated by many major carriers toward short line operators. Short lines are, to an extent, competitors with the major carriers, and for that reason many Class I carriers favored abandonment and salvage over short line creation. That attitude changed virtually overnight with the Gulf & Mississippi decision. Today, most major carriers have established planning groups that analyze light density lines and identify those with the best potential for short line rail operations. Some carriers, like the Southern Pacific, are actually packaging lines for sale to potential operators, and in several cases (such as the Southern Pacific-Eureka Southern transaction), the Class I carrier has actually provided financing to ensure completion of the deal. Most important, the Class I carriers are cooperating in establishing joint rate and division agreements with short line operators on their former branch lines. These are positive developments, and it is essential to recognize that imposition of labor protection on these types of cases would undermine both the economics and the attitude of cooperation that have made the rapid growth in short line railroad development possible.

In the larger divestitures -- like the recently established Chicago Central and Pacific -- labor and management have been successful in negotiating agreements which satisfy labor's demands, but at cost levels consistent with the needs of a regional railroad. There is no reason to believe these issues cannot continue to be resolved on a case-by-case basis. To legislatively impose New York Dock or Oregon Short Line protection on all light density divestitures amounts to a direct trade-off between protection on the one hand and jobs and service on the other.

2. It is essential to recognize reasonable distinctions between larger and smaller railroads in the formulation of federal rules and policies.

Mandated costs and reporting requirements place a greater burden on small carriers, which have a smaller traffic base over which to spread those costs. We need to build flexibility for the smaller carriers into our statutes and rules wherever it is reasonable to do so.

3. The availability and cost of insurance will continue to be a major issue for smaller carriers.

It would be very difficult for companies of this size to establish a captive insurer, as the major carriers have done. The Committee needs to weigh that factor in making its judgments on the varied and complex insurance issues now before it. One issue that needs to be analyzed with particular care is the impact of the Federal Employers' Liability Act (FELA) on these smaller carriers. FELA is an

extremely expensive compensation system, one in which a high percentage of the dollars goes to middlemen. Its burden falls particularly hard on smaller carriers. The Committee should consider options ranging from revising the system (protecting the worker while lightning the burden on these companies by reducing the middleman's share) to giving smaller carriers the ability to elect state worker's compensation coverage.

4. Finally, it is essential to recognize the importance of the Staggers Act ratemaking flexibility and contractual powers to the successful operation of a short line railroad.

Protection of these reforms is an important element in any overall small railroad policy.

Secretary Dole and I share this Committee's concern over the future of small, independent, regional carriers. Within our areas of responsibility, the Federal Railroad Administration has been aggressive in removing barriers to successful short line organization.

1. While we generally require railroads, regardless of size, to meet the same safety standards, we have substantially altered record keeping and reporting requirements applicable to smaller carriers. Two paperwork reduction rulemakings were completed in 1985, and we have provided special relief for short line carriers in new rulemakings.

2. We have crafted a special exemption from FRA track standards to permit continued operation on agricultural branch lines that would otherwise be unable to bear the expense of meeting FRA standards. There are thousands of miles of deteriorated, light density rail lines serving elevators throughout the grain belt. For the shippers they serve, these are important connections. But their shipping volume is much too light to finance the type of maintenance needed to keep the track in conformance with FRA standards. To make it possible for these short lines to exist, we have created a special exception to our standards when ...

- No hazardous material moves on a line, and
- No traffic moves at speeds in excess of ten miles-per-hour.

There are many short lines operating today in the Midwest solely because of this "excepted track" provision.

3. One of the most difficult problems facing communities served by light density lines is a need for expertise, a need for unbiased advice on how to cost out their options, what information to seek from the carriers, and how to locate and evaluate potential short line operators. When abandonment is imminent, these issues must be raised and resolved in relatively short time frames. FRA has taken the initiative in assisting shippers and communities confronted with these

problems by creating a "strike force" which, upon request from shippers or community officials, will inspect the line in question and help shippers intelligently assess their options. Over the past two years, the strike force has worked with shippers and communities from South Dakota to Louisiana, and from South Carolina to the state of Washington. It assisted in the expansion of Dakota Rail, which serves both South Dakota and Minnesota, and after last year's disastrous flooding in the east, it assisted small railroads in West Virginia and Pennsylvania in estimating rehabilitation needs.

4. Finally, FRA continues to administer the remaining appropriations under a variety of grant and loan programs that are in the process of being phased out. Under Section 401 of the Railroad Revitalization and Regulatory Reform Act of 1976 (the 4R Act), we also retain authority to grant transactional antitrust immunity for restructuring discussions involving several carriers. This could be particularly helpful if the ideal short line configuration to emerge from a restructuring is composed of spun-off lines from two or more Class I railroads.

FRA will continue these efforts in the years ahead, and we look forward to working with the Committee to assist this section of the railroad industry, along with the communities and shippers who depend on it.